

## ANALYSIS OF AMENDED BILL

Author: Levine Analyst: Gail Hall Bill Number: AB 1525  
 Related Bills: See Legislative History Telephone: 845-6111 Amended Date: August 18, 2005  
 Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Election To Treat Certain Stock Purchases As Asset Acquisitions For Federal Purposes Shall Be Treated As A State Election/Election Shall Not Be Allowed For State Purposes Unless Federal Election/California National Guard Health Premiums Credit.

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 22, 2005, STILL APPLIES.

OTHER – See comments below.

## SUMMARY

This bill would:

1. provide special rules for taxpayers electing to treat certain purchases of stock as the purchase of assets (IRC Section 338 elections), and
2. provide a tax credit for members of the California National Guard and their families that purchase health care.

## SUMMARY OF AMENDMENTS

The August 16, 2005, amendments added language that provides a tax credit for members of the California National Guard and their families. As a result of the amendments, an analysis for the tax credit is included below. The analysis for the IRC Section 338 election, as discussed in the department's analysis of the bill as introduced February 22, 2005, still applies, and is not discussed in this analysis except for in the SUMMARY, PURPOSE OF THE BILL, and ECONOMIC IMPACT portions of this analysis.

Board Position:

\_\_\_\_\_ S \_\_\_\_\_ NA \_\_\_\_\_ NP  
 \_\_\_\_\_ SA \_\_\_\_\_ O \_\_\_\_\_ NAR  
 \_\_\_\_\_ N \_\_\_\_\_ OUA ☒ PENDING

Department Director

Date

## **PURPOSE OF THE BILL**

According to the author's staff, the purpose of this bill is to promote consistent reporting of income between states so taxpayers pay their fair share of the tax and to assist members of the California National Guard and their families purchase health care.

## **EFFECTIVE/OPERATIVE DATE**

This bill is a tax levy and would be effective immediately upon enactment, and if enacted in 2005, it would be operative for taxable years beginning on or after January 1, 2005.

## **POSITION**

Pending.

## **ANALYSIS**

### **FEDERAL/STATE LAW**

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or influence behavior (e.g., solar and wind energy system credit). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Federal law provides a refundable credit for health insurance costs of trade-displaced workers and certain pension recipients. The refundable credit is equal to 65% of qualifying health insurance costs.<sup>1</sup> Federal law also provides a refundable child tax credit equal to \$1,000 per child and a refundable earned income credit equal to a specific percentage times the amount of the individual's earned income. State law provides a refundable Household and Dependent Care Credit that is equal to a percentage of the allowable federal Household and Dependent Care Credit.<sup>2</sup>

### **THIS BILL**

This bill would:

1. provide a refundable tax credit equal to the amount paid or incurred by a qualified member, or that member's spouse, for qualified health insurance premiums,
2. provide that the credit shall not exceed \$4,000 for married filing joint and single individuals, or \$2,000 in the case of married filing separate individuals,
3. provide that a "qualified member" is an individual serving satisfactorily as an active member of the California National Guard, including those on state or federal active duty,

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<sup>1</sup> Internal Revenue Code (IRC) Section 35.

<sup>2</sup> Revenue and Taxation Code (R&TC) Section 17052.6.

4. define “qualified health insurance premiums” as expenses that would qualify for the medical expense itemized deduction or as a health insurance expense for self-employed individuals,
5. provide that an individual may not claim a deduction and a credit for the same health insurance premium expenses,
6. provide that the credit is refundable upon appropriation by the Legislature,
7. provide that for purposes of this credit, spouse will also mean domestic partner, and
8. provide that the Military Department will give the department an annual listing of members of the California National Guard eligible to claim the credit.

## **IMPLEMENTATION CONSIDERATIONS**

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update. See the FISCAL IMPACT portion of this analysis for additional information.

## **LEGISLATIVE HISTORY**

AB 294 (Blakeslee/DeVore, 2005/2006) would allow a refundable tax credit equal to the amount paid by a member of the California National Guard for life insurance premiums. This bill is currently in the Assembly Appropriations Committee.

AB 1862 (Wyman, 2001/2002) would have allowed employers a tax credit equal to 50% of benefits paid to a member of the California National Guard or U.S. Military Reserve Organization. This bill was held in the Assembly Revenue and Taxation Committee.

## **OTHER STATES' INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. These states do not provide a tax credit comparable to the tax credit allowed in this bill.

## **FISCAL IMPACT**

The department costs to administer the refundable tax credit are estimated at \$554,329 for one-time costs and \$140,691 for annual costs. The estimated costs include activities such as research, programming, testing, forms development and analysis, data entry, and fraud prevention.

## **ECONOMIC IMPACT**

### Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would have the following revenue effects.

Estimated Revenue Impact of AB 1525 <b>As Amended 8/18/05</b> [\$ In Millions]			
Provision	2005-06	2006-07	2007-08
338 Elections	\$50	\$55	\$60
CA National Guard Credit	-\$30	-\$45	-\$50
Net Impact	\$20	\$10	\$10

**Tax Revenue Discussion** (IRC Section 338 elections)

The revenue impact of the election provision would be determined by the difference in income assigned to California under the proposal compared with present law, the average apportionment factor, and the average tax rate of corporations making elections for treatment of certain acquisitions.

Based on available data, merger and acquisition spending in the U.S. totaled \$777 billion in 2004. The following adjustments were applied to this data.

- Acquisition spending is assumed to represent one-quarter of total merger and acquisition spending, or nearly \$195 billion ( $\$777 \text{ billion} \times 1/4 = \$195 \text{ billion}$ );
- Of total acquisition spending, 50% is assumed gain on transactions, or \$98 billion ( $\$195 \text{ billion} \times 50\% = \$98 \text{ billion}$ );
- The portion of gain on transactions affected by inconsistent sourcing rules (i.e., IRC Section 338 elections) that create “nowhere income” is projected at 12.5%, or \$12.3 billion ( $\$98 \text{ billion} \times 12.5\% = \$12.3 \text{ billion}$ );
- Applied an average apportionment factor of 6.5% ( $6.5\% \times \$12.3 \text{ billion} = \$800 \text{ million}$ ); and
- Applied an average tax rate of 6% ( $6\% \times \$800 \text{ million} = \$48 \text{ million}$ ).

The estimate at the 2004 level is grown to subsequent taxable years by the projected growth in corporate profits as forecasted by the Department of Finance. Taxable year estimates are converted to cash flow estimates in the table.

**Tax Revenue Discussion** (CA National Guard Credit)

The revenue impact of the refundable credit provision would be determined by the number of qualified members and the average amount incurred for qualified health insurance premiums.

According to the National Guard, there are approximately 20,300 California members. While serving on active duty, National Guard members receive health insurance for themselves and their families. But before they are activated, they have health insurance only if they are covered on their civilian jobs. Available information indicates that roughly 75%, or 15,225 members, currently have health insurance and that 25%, or 5,075 members, are currently uninsured.

Of members with health insurance, each would be eligible for the proposed credit for costs incurred for their portion of qualified health insurance premiums. According to an employer health benefits

survey conducted in 2004, workers on average contribute \$558 of the \$3,695 annual cost of single coverage and \$2,661 of the \$9,950 annual cost of family coverage toward premiums. For the estimate, these amounts are grown 10% annually beginning with 2005. Therefore, in 2005, it is projected that workers contribute \$614 of the \$4,065 annual cost of single coverage and \$2,927 of the \$10,945 annual cost of family coverage toward premiums. As a proxy, marital status of Guard members is used to determine whether a member might contribute toward the annual cost of single or family coverage.

In 2005, for members who already have health insurance, costs eligible for the credit are derived as follows:

<u>Number of Members</u>	<u>Health Coverage</u>	<u>Average Cost Incurred per Member</u>	<u>Total Costs Eligible for Credit [Millions]</u>
5,853	Single	\$614	\$3.6
<u>9,372</u>	Family	\$2,927	<u>\$27.4</u>
15,225			\$31.0

Of uninsured members, it is assumed that three-quarters are single and one-quarter, married. It is further assumed that half of the uninsured single members and one-quarter of uninsured married members will acquire qualified health insurance under the bill. These uninsured members, who acquire health coverage under the bill, will pay the annual cost of single or family coverage entirely out-of-pocket. In 2005, for uninsured members, costs eligible for the credit are derived as follows:

<u>Number of Members</u>	<u>Health Coverage Acquired</u>	<u>Lesser of Average Cost Incurred per Member Or Maximum Credit Amount</u>	<u>Total Costs Eligible for Credit [Millions]</u>
1,903	Single	\$4,000	\$7.6
<u>317</u>	Family	\$4,000	<u>\$1.3</u>
2,220			\$8.9

For 2005, costs eligible for the refundable credit total \$39.9 million. Due to late enactment, it is estimated that only three-quarters of the full year impact would occur, or \$30 million in 2005-06. Estimates in subsequent years increase due to projected increases in the cost of health insurance. Even with the proposed credit, it is estimated that 2,855 members will remain uninsured [15,225 + 2,220 + 2,855 = 20,300 California members].

## LEGISLATIVE STAFF CONTACT

Gail Hall  
Franchise Tax Board  
(916) 845-6111  
[gail.hall@ftb.ca.gov](mailto:gail.hall@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
(916) 845-6333  
[brian.putler@ftb.ca.gov](mailto:brian.putler@ftb.ca.gov)